

Message Text

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E.O. 11652: GDS
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SUBJ: NEW ECONOMIC PROGRAM: ACTION ON SUOMIDIES MAY BE DE-
LAYED UNTIL 1978

REF: COLOMBO 4098

1. SUMMARY: CENTRAL BANK DEPUTY GOVERNOR TILAKARATNA TOLD THE AMBASSADOR THAT SOME SLIPPAGE IS OCCURRING IN THE TIMING OF THE NEW ECONOMIC PROGRAM OUTLINED REFTEL. THE NOVEMBER 15 BUDGET SPEECH WILL CONCENTRATE ON THE GOOD NEWS OF JOB CREATION AND LIBERALIZED IMPORTS AND FOREIGN EXCHANGE, WHILE SAVING THE BAD NEWS OF REDUCED SUBSIDIES UNTIL SOMETIME EARLY NEXT YEAR. HOW SUBSIDIES WILL BE CUT AND REORGANIZED IS STILL UNDER DEBATE, BUT TILAKARATNA BELIEVES THE PRIME MINISTER AND OTHER IMPORTANT MEMBERS OF THE CABINET FULLY UNDERSTAND THE NEED FOR A NET REDUCTION IN SPENDING ON CONSUMPTION AND A NET INCREASE IN INVESTMENT. WE WILL CONTINUE TO MONITOR AND REPORT ON THE PROGRESS AND TIMING OF NEW ECONOMIC POLICIES.
END SUMMARY.

2. PROGRAM SLIPPAGE
DURING LUNCH ON NOVEMBER 3, DR. TILAKARATNA TOLD THE AMBASSADOR
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AND EMBOFF THAT THERE HAS BEEN SOME SLIPPAGE IN THE GOVERNMENT OF SRI LANKA'S (GSL) ECONOMIC PROGRAM AS COMPARED WITH WHAT MINISTER RONNIE DE MEL TOLD PEOPLE IN WASHINGTON. THE AMOUNT OF THE BUDGET DEVOTED TO INVESTMENT WILL BE LESS THAN ORIGINALLY EXPECTED AND ACTION TO CUT SUBSIDIES WILL BE DELAYED UNTIL SOMETIME AFTER THE BUDGET SPEECH. THE ORIGINAL PLAN HAD BEEN TO SIPHON OFF APPROXIMATELY RS. 3 BILLION FROM INCREASED

REVENUES OBTAINED FROM HIGHER EXPORT TAXES ON TEA, RUBBER AND COCONUT FOLLOWING THE DEVALUATION OF THE OFFICIAL RATE. THESE FUNDS WERE TO BE PLACED IN A SPECIAL DEVELOPMENT BANK WHICH WOULD FINANCE PROJECTS OTHER THAN THOSE INCLUDED IN THE REGULAR CAPITAL BUDGET. IN ADDITION, CAPITAL BUDGET SPENDING WOULD BE KEPT AT THE HIGH 1976 LEVEL (RS. 2.7 BILLION) IN REAL TERMS. ALL OF THIS WAS TO BE DONE WITHOUT A BUDGET DEFICIT.

3. TILAKARATNA SAID THAT THE CURRENT THINKING IS TO STICK TO THE NO-DEFICIT RULE AND TO MAINTAIN REAL CAPITAL SPENDING, BUT THE FUNDS AVAILABLE FOR THE DEVELOPMENT BANK WILL PROBABLY BE ONLY ABOUT 10 PERCENT OF ORIGINAL EXPECTATIONS, OR RS. 300 MILLION. POLITICAL PRZ SURE IS BUILDING ON THE GSL NOT TO MAKE DRASTIC CUTS IN THE FOOD SUBSIDY PROGRAM. THE PRESENT GAME PLAN IS TO HAVE THE BUDGET SPEECH CONCENTRATE ON EMPLOYMENT AND OTHER GOODIES, AND TO SAVE THE BAD NEWS FOR LATER. ACTION TO REDUCE THE RATION PROGRAM WILL PROBABLY NOT COME UNTIL JANUARY, AND NOTHING WILL BE DONE TO INCREASE WHEAT FLOUR PRICES UNTIL WELL INTO NEXT YEAR.

4. ONE OF TILAKARATNA'S CONCERNS IS THAT THE GSL WILL GET USED TO THE HIGHER LEVEL OF SPENDING BASED ON THE CURRENT RELATIVELY HIGH WORLD PRICE FOR TEA. THE IDEA OF THE DEVELOPMENT BANK WAS THAT IF AND WHEN TEA PRICES FALL, IN THE SHORT RUN ALLOCATIONS TO THE BANK COULD BE REDUCED ACCORDINGLY. CONFIDENTIAL

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IF, HOWEVER, THE GSL GETS USED TO HAVING THESE FUNDS IN THE BUDGET AND TEA PRICES DROP, THERE GOES THE NO-DEFICIT POLICY. IN THE LONGER RUN, MANY SENIOR GSL OFFICIALS LOOK TO THE FREE TRADE ZONE (FTZ) TO MAINTAIN OR INCREASE FOREIGN EXCHANGE EARNINGS. TILAKARATNA'S PERSONAL VIEW IS THAT THE FTZ WILL NOT PRODUCE MUCH FOR SEVERAL YEARS AT LEAST, AND A BETTER BET WOULD BE TO STIMULATE GREATER PRODUCTION OF SUBSIDIARY FOOD CROPS AS AN IMPORT SUBSTITUTION DEVICE. THIS COULD BE DONE THROUGH A COMINATION OF DIRECT GSL ASSISTANCE TO FARMERS AND HIGH GUARANTEED PRICES.

5. THE PLAN TO LIBERALIZE THE ECONOMY IS STILL OFFTRACK. MOST IMPORT AND FOREIGN EXCHANGE BARRIERS WILL BE RELAXED, AND THE OFFICIAL EXCHANGE RATE WILL BE DEVALUED. AFTER THE INITIAL FLOOD OF IMPORTS, TILAKARATNA SAID HE EXPECTED IMPORTS TO STABILIZE AT A MANAGEABLE LEVEL.

6. SUBSIDIES

JUST HOW SUBSIDIES WILL BE REDUCED OR CHANGED IS STILL UNDER DEBATE. SOME PEOPLE ARE PUSHING TO RAISE THE "POVERTY LINE" CUT OFF FOR SUBSIDIES SO THAT MORE THAN HALF THE POPULATION WILL CONTINUE TO RECEIVE CHEAP FOOD. TILAKARATNA BELIEVES,

HOWEVER, THAT THE FINAL DECISION WILL BE TO TAKE SUBSIDIES AWAY FROM THE AFFLUENT HALF OF THE POPULATION. HE SAID THE PRIME MINISTER AND OTHER IMPORTANT OFFICIALS RECOGNIZE THAT ALTHOUGH YOU GIVE WITH ONE HAND AND TAKE AWAY WITH THE OTHER, THE NET RESULT MUST BEIR REDUCTION IN CONSUMPTION SUBSIDIES AND AN INCREASE IN INVESTMENT FOR DEVELOPMENT. IN THIS REGARD, HE NOTED THAT THE PRESENT CABINET IS THE MOST RECEPTIVE TO DOING WHAT IS NECESSARY HE HAS SEEN IN THE 25 YEARS HE HAS BEEN INVOLVED IN ECONOMIC POLICY MATTERS. APART FROM PRMIN MINISTER J.RGP JAYEWARDENE, WHO HAS KNOWN WHAT SHOULD BE DONE SINCE HE WAS SRI LANKA'S FIRST FINANCE MINISTER AFTER INDEPENDENCE, TILAKARATNA SPECIFICALLY MENTIONED HOUSING MINISTER PREMADASA AS SOMEONE YOU COULD TALK TO AND WHO UNDERSTOOD THE BASIC PROBLEMS. THIS CABINET, HOWEMOR, IS VERY URBAN ORIENTED, AND CONFIDENTIAL

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THERE IS SOME DANGER TTQT THEY MAY NOT GIVE ENOUGH CONSIDERATION TO THE NEEDS OF THE RURAL POPULATION.

7. OTHER ISSUES

THE GUARANTEED PRICE SCHEME FOR PADDY IS NOT WORKING DUE TO THE PMB'S STORAGE AND MILLING CAPACITY LIMITATIONS. AS THE GSL HOPES TO BUILD UP A FOOD BUFFER STOCK TO HELP STABILIZE DOMESTIC PRICES, INCREASED STORAGE CAPACITY IS A PRIORITY CONCERN FOR THE GSL.

8. THERE IS CONSIDERABLE SCOPE FOR MORE EMPLOYMENT IN THE ESTATE SECTOR. IF WAGES AND WORKING CONDITIONS ARE IMPROVED, TILAKARATNE BELIEVES THAT SINHALESE WILL WORK ON THE TEA ESTATES REPLACING TAMILS REPATRIATED TO INDIA. HE ADMITTED, HOWEVER, THAT THE PRESENT ESTATE WORKERS ARE THE MOST PRODUCTIVE IN THE COUNTRY AND PRODUCTIVITY MAY DROP IF TAMILS ARE REPLACED BY SINHALESE.

9. THE GSL WILL NOT ENTER INTO A STANDBY ARRANGEMENT WITH THE IMF UNTIL AFTER THE BUDGET SPEECH. THE TERMS AND CONDITIONS OF THE STANDBY WILL DEPEND ON WHAT IS OR IS NOT FINALLY INCLUDED IN THE SPEECH.

10. EMBASSY COMMENT: WE WILL CONTINUE TO MONITOR THIS IMPORTANT INTERNAL DEBATE AND HOPE TO ALERT THE DEPARTMENT IN ADVANCE TO CHANGES IN THE SUBSTANCE AND TIMING OF THE GOVERNMENT'S ECONOMIC POLICY PACKAGE. AMBASSADOR CONCURS WITH TILAKARATNA'S ASSESSMENT THAT THIS IS THE MOST ECONOMICALLY SOPHISTICATED AND RESPONSIBLE OF ALL THE CABINETS OF THE PAST TWENTY YEARS.
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